

The Rationale and Effects of China's Belt and Road Initiative:

Reducing Vulnerabilities in Domestic Political Economy

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Hongyi LAI

Associate Professor

School of Politics and International Relations

University of Nottingham, UK

[Hongyi.lai@nottingham.ac.uk](mailto:Hongyi.lai@nottingham.ac.uk)

Abstract: The existing literature suggests that China launched the belt and road initiative (BRI) in order to stimulate economic growth through infrastructural investment abroad, foster closer economic ties with Eurasia, and counter the US pivot to Asia. In this article, the BRI is interpreted in a deeper context through an analysis of its role in sustaining the economic and political regime in China and in reducing vulnerabilities in domestic political economy. These vulnerabilities include surplus industrial capacity, heavy reliance on energy imports, and under-development of the western region. Post-2012 data suggest that the BRI has partially instead of fully enabled China to ease surplus industrial capacity, secure energy importing routes (especially imports through pipelines), and enhance the economic profile of China's western region.

In 2013 China's President Xi Jinping and Premier Li Keqiang announced the belt and road initiative (BRI) in their speeches on China-Kazakhstan and China-ASEAN relations, respectively. The BRI is arguably one of the most ambitious and expensive international strategies China has ever undertaken since it embarked upon economic reform in 1978. The BRI aims to build two clusters of nations along two economic belts, i.e., namely, the land-based economic corridor along the old Silk Road connecting western China through Central Asia, the Middle East, Eastern, Southern, and Western Europe, and the maritime economic belt connecting southeast coastal China with Southeast Asia, South Asia, the Gulf states, East Africa and Europe. In the following years, the BRI has been incorporated into major political meetings or the most important political documents in China, including the Third Plenary Session of the 18th Central Committee of the Communist Party of China in late 2013, the government work report delivered by Premier Li Keqiang to the legislature in March 2014, and the amended constitution of the People's Republic of China in October 2017.<sup>1</sup>

Commensurate with these high-profile announcements and declarations have been massive efforts and material inputs into the BRI, including numerous investment projects and trade-promoting agreements. According to the Chinese governmental source, in the first five years of the launch of the BRI, over 100 countries and international organizations have inked pacts to foster cooperation with China over the BRI, China's trade with nations along the Belt and Road surpassed US\$5 trillion, and China's foreign direct investment in non-financial sectors in these countries totaled US\$80 billion.<sup>2</sup>

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<sup>1</sup> "Chronology of China's Belt and Road Initiative," posted at [http://www.xinhuanet.com/english/2015-03/28/c\\_134105435.htm](http://www.xinhuanet.com/english/2015-03/28/c_134105435.htm) on 28 March 2015, accessed January 9, 2018.

<sup>2</sup> "Factbox: Belt and Road Initiative in five years," posted at [http://www.xinhuanet.com/english/2018-08/26/c\\_137420914.htm](http://www.xinhuanet.com/english/2018-08/26/c_137420914.htm) on August 26, 2018, accessed January 9, 2019.

The scholarly literature and policy analyses on the BRI have been growing. Much attention has been paid to the economic and political motivations of the BRI and its components and major projects. The existing literature suggests that three main objectives have motivated China's leaders to inaugurate the BRI—to generate economic growth through infrastructural investment, to foster economic, infrastructural and political linkage of strategic importance with Eurasia, and to counter the US pivot to Asia.

Acknowledging the relevance of the three aforementioned motivations, several other highly significant causes concerning the domestic political economy are under-explored. This article aims to fill the gap in the literature by investigating the linkage between domestic political economy and the launch of the BRI. It suggests that domestic considerations behind this ambitious strategy and inadequately investigated include finding external outlets for China's surplus capacity in industrial sectors, securing China's energy importing routes, and augmenting the economy of the western region. It also assesses the accomplishment of these three objectives in the wake of the BRI.

The underlying theme of this article is that China's major foreign policy cannot be simply viewed as a response toward a recent external stimulus (such as the US pressurizing schemes such as the TPP), or merely a remedy to a present domestic economic problem such as a slowdown in economic growth in China. Rather, China's foreign policy needs to be interpreted against a deeper context, namely, its role in reducing three economic vulnerabilities of the prevalent economic regime in China and in sustaining this regime and the political regime which rests on the economic regime. The first noticeable feature in China's economic regime is the pursuit of high growth through heavy investment, resulting in

excessive capacity across a number of heavy industrial sectors that tend to be dominated by state enterprises. In addition, China's model of economic growth is energy-intensive and its growth has been achieved through heavy consumption of energy such as coal, oil, and gas. Finally, China's economic growth relies overwhelmingly on the coast. The BRI would help to find additional markets for surplus industrial capacity, secure alternate energy importing routes, and increase the contribution from the western region toward national growth.

The subsequent parts of this article are as follows. First, the existing literature on the motivations of the BRI will be reviewed and the gaps will be identified. Second, a brief review of relevant theories and an outline of the analytical perspective will be provided. Third, a detailed analysis of the major motivations of China's BRI related to its domestic political economy will be offered, followed by an assessment of the accomplishment of these objectives on the basis of available data. Understandably, the assessment here will not be a systemic one due to the focus and limited space of my article. A systemic evaluation will require a lengthy assessment of the accomplishment of other goals not elucidated in this article, such as the external geopolitical and external geoeconomic reasons. Finally, the author summarizes the argument and findings of the article. It is argued that the BRI reflects China's leaders' attempts to mitigate the bottlenecks in China's economic system and that the BRI has only resulted in the partial accomplishment of the aforementioned three objectives.

## Literature Review

A stream of literature has gradually emerged and expanded on the BRI. The authors ranged from economists, political scientists, policy analysts, geographers, and scholars on transportation and logistics. Much of the literature is devoted to the motivations, the

rationale, as well as components of the initiative. In this section, greater attention will be paid to the motivations of the BRI, which are the theme of this article.

A number of political scientists, as well as political economists, such as Swaine (2015), Wang (2016), Ferdinand (2017), and Yu (2017), emphasize China's seeking greater international influences and external security through the BRI. They argued that China used the BRI in order to expand its economic power in Eurasia and that it established the Asia Infrastructural Investment Bank (AIIB) with an aim of shaping the global economic order. Both initiatives served to counter the US initiatives such as the pivot to Asia and the Trans-Pacific Partnership (TPP). In a more recent study, Nordin and Weissmann (2018) suggested that by taking advantage of US President Trump's rejection of free trade agreements such as the TPP and by proposing networked capitalism China could reap diplomatic benefits from the BRI.<sup>3</sup> Several studies also coined the BRI as China's scheme for regional integration. While Ferdinand (2017) saw the BRI as a Chinese and "weaker cross-border integration",<sup>4</sup> Kaczmariski (2017) regarded China's BRI as more inclusive, flexible, open, though functional and vague regionalism than Russia's European Economic Union.<sup>5</sup>

Another motivation for the BRI most commonly mentioned in the literature is to maintain economic growth. As argued by Huang (2016) and Yu (2017), the BRI would allow China to connect closely with economies west to it through infrastructure projects and expand its investment in and trade with these economies, and sustain China's economic growth in the

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<sup>3</sup> Astrid Nordin and Mikael Weissmann, "Will Trump make China great again? The belt and road initiative and international order," *International Affairs* 94: 2 (2018): 231–249.

<sup>4</sup> See Peter Ferdinand, (2016) "Westward ho—the China Dream and 'One Belt, One Road'," *International Affairs* 92: 4: 950.

<sup>5</sup> Marcin Kaczmariski, "Non-western visions of regionalism: China's New Silk Road and Russia's Eurasian Economic Union," *International Affairs*, 93: 6 (2017) 1357–1376.

next phrase.<sup>6</sup> Some Chinese sources maintained that the BRI was beneficial to China's industrial upgrade and economic opening.<sup>7</sup>

Another set of relevant economic motivations that partially overlaps the growth imperative is to stimulate the growth of western China and to relocate some of China's excessive capacities to Southeast Asia.<sup>8</sup> In several recent studies, a brief discussion has been made on the domestic political economy of the BRI. De Jonge (2017) suggested that concerns with overinvestment (which she did not elaborate on and which was reflected in low-quality inventory, excess capacity, and ghost cities) and with environmental degradation helped facilitate the setup of the AIIB.<sup>9</sup> Ye (2019) argued that China's leaders used the BRI to mobilize the fragmented authoritarian state. She noted that China's state banks attempted to enhance their international profile through investing infrastructural projects and by drawing upon local funds from central China.<sup>10</sup> Cai (2018) briefly described China's intention to overcome domestic "industrial overcapacity" and to build new transportation lines through Central Asia, Pakistan and the Malay Peninsula in the BRI.<sup>11</sup> In an examination of multiple aspects of domestic political control in China in the implementation of the BRI, He (2019) observed briefly the rivalry between provinces in China for becoming hubs of external

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<sup>6</sup> Yiping Huang, 2016, "Understanding China's Belt & Road Initiative: Motivation, framework and assessment," *China Economic Review* 40: 314–321.

<sup>7</sup> Swaine, "Chinese Views and Commentary on the 'One Belt, One Road' Initiative".

<sup>8</sup> Hong Yu, "Motivation behind China's 'One Belt, One Road' Initiatives," pp. 357-58.

<sup>9</sup> Alice de Jonge, 2017. "Perspectives on the emerging role of the Asian Infrastructure Investment Bank," *International Affairs* 93: 5: 1061–1084.

<sup>10</sup> Min Ye, 2019, "Fragmentation and Mobilization: Domestic Politics of the Belt and Road in China," *Journal of Contemporary China*, DOI: 10.1080/10670564.2019.1580428.

<sup>11</sup> Kevin G. Cai, 2018, "The One Belt One Road and the Asian Infrastructure Investment Bank: Beijing's New Strategy of Geoeconomics and Geopolitics," *Journal of Contemporary China*, 27: 114: 831-847.

linkage.<sup>12</sup> Nevertheless, the aforementioned studies have yet to offer detailed, empirical and rich data-based analyses of the role of the BRI in easing China's surplus capacity, securing China's rising energy imports and reducing regional inequality. Nor is any assessment of the actual effects of the BRI on addressing these problems.<sup>13</sup> This article hopes to fill these gaps in examining China's motivations in launching the BRI as well as the materialization of these motivations in the wake of the BRI.

The existing theoretical literature, on the other hand, has largely failed to provide a convincing and relevant view on the domestic-external linkages in the launch of the BRI. Mearsheimer, the most prominent neo-realist, argued that China, as a rising power, would try to maximize its power and establish its dominance (especially military preponderance) in northeast Asia. He dismissed the argument that economic interdependence among nations would lead to peace,<sup>14</sup> and ignored domestic political motivations. For Mearsheimer, who focused on the relative power, military development and security arrangements in Northeast Asia in discussing China's future in his most important book,<sup>15</sup> the BRI would not best advance China's hegemony in Northeast Asia, as the main regions covered in the initiative are Central Asia, South Asia, the Middle East, Southeast Asia, and Southern and Eastern Europe, as Northeast Asian economies such as Japan and Taiwan have not participated in the BRI, and as the BRI is first and foremost about trade and investment. Liberals, on the other

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<sup>12</sup> Baogang He. 2019. "The Domestic Politics of the Belt and Road Initiative and its Implications," *Journal of Contemporary China*, 28:116, 180-195, DOI: 10.1080/10670564.2018.1511391.

<sup>13</sup> For example, in a rare mention of China's drive to develop its western region, Ferdinand 2017 stated very briefly as follows: "by 2015 it was estimated that it was still going to need 30–50 years to catch up with the rest of China. The OBOR initiative is partly aimed at speeding up that process." See Peter Ferdinand, (2016) "Westward ho," 951.

<sup>14</sup> John Mearsheimer, *The Tragedy of Great Power Politics*. New York and London: W. W. Norton & Company, p. 371.

<sup>15</sup> *Ibid*, especially pp. 372-402.

hand, do not provide a unified view regarding the external aspects of the BRI. John Ikenberry, a prominent liberal, suggested that China has benefited from the liberal international order.<sup>16</sup> Ikenberry and Lim saw elements of institutional statecraft and multilateralism in the AIIB, a funding vehicle created by China for the BRI.<sup>17</sup> Other liberals voiced their concerns that the BRI could become a debt-trap, despite its financial appeals to the participant nations.<sup>18</sup> In their 2012 edition of their best-known work, Keohane and Nye suggested that inter-dependence and its pacification of inter-state relations applied only to liberal democracies and that they did not heed domestic factors in their analyses.<sup>19</sup>

The only relevant body of literature would be the domestic impact of internationalization, as exemplified by a landmark volume co-edited by Keohane and Miller.<sup>20</sup> Most relevant to this article is the model of factor endowment-induced trade and domestic coalition by Ronald Rogowski, a contributor to this volume. His powerful theory helped to account for a wide range of events of political economy in the wake of trade expansion or retraction.<sup>21</sup> According to his theory, when China's trade was expanding (which was the case around 2012-2013, when China's trade expanded robustly around 8% a year), the political forces championing labor-intensive sectors, where China's factor endowment resides, would prevail,

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<sup>16</sup> See G. John Ikenberry's updated elaboration of the liberal view on the world order, "The End of Liberal International Order?", *International Affairs*, 2018, Vol. 94, no. 1, pp. 7–23.

<sup>17</sup> G. John Ikenberry and Darren J. Lim, "China's Emerging Institutional Statecraft," *Project on International Order and Strategy at BROOKINGS*, April 2017.

<sup>18</sup> "Is There a Liberal International Order?," *IISS, Strategic Survey 2018: The Annual Assessment of Geopolitics*, November 2018.

<sup>19</sup> For sources of these two views, see Robert O. Keohane and Joseph S. Nye, 2012, *Power and Interdependence*, 4<sup>th</sup> edition, Boston: Longman, pp. xxxii-xxxiv, 271.

<sup>20</sup> See Robert O. Keohane and Helen V. Milner, eds. 1996. *Internationalization and Domestic Politics*. Cambridge and New York: Cambridge University Press.

<sup>21</sup> See his following major work--Ronald Rogowski, 1989. *Commerce and Coalitions*. Princeton: Princeton University Press.



causing China to promote exports of these goods, instead of capital-intensive and state firms-dominated infrastructural projects abroad. An effective analytical perspective is thus still needed to expound how the BRI is conceived and has served to reduce vulnerabilities in China's domestic political economy, a topic under-explored by the existing literature.

### Aims and Argument

The aim of this article is to examine and assess China's aforementioned overlooked motivations in launching the BRI. In addition, I will aim to shed analytical light on the domestic considerations applicable to the BRI. My analytical perspective goes beyond the usual portray of the BRI as an addition to the rivalry between two of the biggest powers (namely, the USA and China) for the dominance of Asia. While there is an element of truth in this depiction, it runs the risks of ignoring the other important elements, namely, how the BRI serves China's political-economic regime. I will discuss how the BRI could help prevent the bankruptcy of many state firms in sectors harassed by surplus capacity, help sustain China's model of economic growth, and thus the political regime's legitimacy.

Shirk's argument about the pro-reform coalition in China in the 1980s seems applicable to a certain degree. She argued that China's leaders mustered support from a coalition of elites representing coastal provinces and light industry and used their backing to forge ahead with fiscal and SOE reforms.<sup>22</sup> Applying her insights to the three vulnerabilities I will focus on, one could suggest that in launching the BRI China's leaders catered to the following sectoral, provincial and even ministerial interests. They included 1) a number of industries (mostly

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<sup>22</sup> Susan Shirk, 1993. *The Political Logic of Economic Reform in China*. Berkeley: University of California Press, pp. 129-45.

extractive and heavy industry) whose surplus capacity has threatened their survival and most of which are dominated by state-owned enterprises (SOEs), 2) the twelve western provinces whose opening has been restricted by their land-locked location and whose favorable share in national allocation of resources in the wake of the western development launched in 2001 seemed to have waded in the later years, 3) a range of powerful national ministries and bureaus of overlooking sectors saddled with surplus capacity and managing its consequences (such as Finance, Human Resources and Social Security, Commerce, People's Bank, State-owned Assets Supervision and Administration Commission, Taxation, Transport, Railway, and Energy), 4) national ministries and bureaus supervising western provinces (such as Ethnic Affairs and Religious Affairs), and 5) powerful state agglomerates which stand to gain from the BRI, especially transport, railway, and energy. In addition, a number of coastal provinces such as Fujian, Zhejiang, Shanghai, and Guangdong would also benefit due to their linkage with the maritime silk road (one of the two components of the BRI). However, limited space will allow me to discuss mainly the first two of the aforementioned interests and sketch instead of developing a detailed analytical framework. Rather, I argue that the interests of these sectors and the catch-up of the western provinces with the coast concern the well-being of China's economic regime, a cornerstone of the legitimacy of the ruling party. This is particularly so since most of the industries with surplus capacity are populated with large national and local state enterprises and since the state and the current leadership view the state ownership as the corporate basis of the ruling party.

In this article I propose that through the BRI China's leaders hoped to reduce economic vulnerabilities and sustain high economic growth, thereby sustaining the political legitimacy of the ruling party. In the reform era "delivering the economic goods" has been used by the

ruling party in China as a key avenue to earn popular support.<sup>23</sup> In the wake of the global financial crisis in 2008, however, China's economic growth has been decelerating noticeably over the years, from 10.6% in 2010 to 9.5% in 2011, 7.9% in 2012, 7.8% in 2013, 7.3% in 2014 and 6.9% in 2015.<sup>24</sup> As a result, in May 2014 the Chinese President Xi Jinping talked about a slower annual growth rate in China below 7% as "the new normal".<sup>25</sup> As he emerged as China's top leader in early 2013, Xi felt the need to sustain economic growth against the downward trend. Doing so would help to maintain his credibility as an able leader and sustain the party's legitimacy among the Chinese population who has been largely acquiescent toward the one-party rule in exchange for their rising living standard.

As to be detailed later, in order to sustain China's economic growth, Xi would need to address the severe excessive capacity of industrial sectors, find new external and domestic markets. Finally, through the BRI Xi sought to reduce the high reliance on China's growth on its coast and enhance the economic profile of western China. Meeting these objectives would help sustain the present investment-intensive and state-firms-prominent growth model. In this article, a mainly qualitative approach will be adopted. In my analysis, I will not only outline the official intention of reducing economic vulnerabilities but also examine the data that help to shed light on the effects of the BRI on easing these vulnerabilities. I try to advance my analysis of the causes and effects of China's BRI on the basis of abundant

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<sup>23</sup> Yongnian Zheng and Liang Fook Lye, 2005. "Political Legitimacy in China," in Lynn White, ed. *Legitimacy*, New Jersey and London: World Scientific, pp. 183-203; Tony Saich, 2015. *Governance and Politics of China*. London and New York: Palgrave, p. 250.

<sup>24</sup> World Bank data from <https://data.worldbank.org/indicator/NY.GDP.MKTP.KD.ZG?locations=CN>, accessed June 1, 2017.

<sup>25</sup> "Fixing economy, debt will be Xi Jinping's next focus," *South China Morning Post*, October 11, 2017, posted at <https://www.straitstimes.com/asia/east-asia/fixing-economy-debt-will-be-xis-next-focus-experts>, accessed October 20, 2017.

empirical evidence. For this reason, multiple sources of information will be utilized to gain a fuller view of the topic. Firstly, scholarly publications from China, especially economist analyses on the surplus capacity of the industrial sectors before and after the BRI, provide us an academic perspective of internal problems of China's economy. News reports and online commentaries outside and inside China and official publications from China allow us to get up-to-date data and development. Furthermore, data from established western statistical websites and organizations, as well as data from China Statistical Bureau on economic conditions over the years or across the provinces, offer us valuable and indispensable evidence on the effects of the BRI on the easing of the domestic economic concerns of China.

## China's Rationale of BRI

### *Seek New Markets for Surplus Capacity and Exports*

In the recent two decades, China has experienced severe surplus capacity in the industry, especially in heavy industry. The causes of surplus are complex and a thorough investigation is beyond the scope and space of this article. Instead, it may be useful to provide an overview of this topic on the basis of several academic studies published in China. Leading economists in China such as Justin Yifu Lin regarded surplus capacity as a result of over-expansion of firms that tend to embrace economic optimism in a rapidly developing economy.<sup>26</sup> Their attribution of surplus capacity to market failure, however, seems to be a minority. Many other economists in China regard surplus capacity as a result of governmental failure. For example, among several later studies, Dong, Liang, and Zhang

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<sup>26</sup> See Justin Lin, et al. 2010. "'The Surge Phenomenon' and the Formation Mechanism of Surplus Capacity," *Jingji Yanjiu (Economic Research)* 10: 4-19.

(2015) found that surplus capacity tended to be associated with heavy industrial sectors such as mining and extraction, public utilities, state ownership, and inland areas.<sup>27</sup> Yu and Jin (2018) maintained that surplus capacity was caused by local governmental official zealous pursuit of economic growth in order to polish economic performance for promotion, as well as by China's fiscal stimulus package in the wake of the 2008 financial crisis.<sup>28</sup> Their view was reinforced by a panel data analysis of industrial sectors during 2006-16 by Chen, Li and Zhu (2019) who concluded that soft budget constraints, governmental support for sectors, and expanding sizes of the firms and sectors and a lower level of openness were associated with a higher level of surplus capacity.<sup>29</sup>

In most of the years during 2008-2012 prior to the launch of the BRI, investment on average contributed to 59% of China's GDP growth, surpassing consumption and net exports to be the largest contributor to growth.<sup>30</sup> Compared to large developed economies such as the United States, investment and net exports have played a larger role and consumption a smaller role in China's economic growth. Take 2017 as an example, consumption contributed to 59% of China's GDP growth, investment's contribution decreased to 32% and that of net exports went up to 9%. In the last three quarters in 2017 in the United States, the

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<sup>27</sup> Minjie Dong, Yongmei Liang, and Qizi Zhang, 2015. "Industrial Capacity Utilization of China: Industry Comparisons, Regional Gap and Causes," *Jingji yanjiu (Economic Research)*, No. 1: 84-98.

<sup>28</sup> Yu Miaojie and Jin Yang, 2018. "The Present Conditions, Causes, Consequences and Remedies of Surplus Capacity," *Changan Daxue Xuebao (Shehui kexueban)(Journal of Chang'an University—Social Sciences Edition)*, 20:5 (September): 48-60. For a similar argument about the government's role in surplus capacity covering the earlier decades, see Wei Houkai, 2003, *Shichang Jingzheng, Jingji Jixiao yu Chanye Jizhong (Market Competition, Performance, and Industrial Concentration)*. Beijing: Jingji guanli chubanshe.

<sup>29</sup> Chen Junlong, Li Liangzhe, and Zhu Jing, 2019, "An Analysis of Governmental Behaviour and the Emergence and Remedies of Surplus Capacity," *Dobei Daxue Xuebao (Shehui kexueban)(Journal of Northeastern University (Social Science))*, 21:4 (July): 360-5.

<sup>30</sup> National Bureau of Statistics of China (NBS), *China Statistical Yearbook 2018*, Table 3-17.

growth contribution from consumption was 78% (nearly 20% above China), investment 28% (4% lower than China), and net exports -12%.<sup>31</sup> As economic growth in China relies relatively heavily on investment and net exports and less on consumption, excessive production capacity would arise, creating pressure on the government to seek external markets for the excess capacity. In a wider context, China's heavy-investment driven growth resembles the developmental path traveled by a number of East Asian industrialized economies, such as Japan, South Korea, Taiwan, and Singapore. According to the World Bank, these economies generated high investment rates through provisioning sound fundamentals such as schooling, sound financial institutions, and public investment in infrastructure and used mild financial repression to encourage investment.<sup>32</sup> However, one noted a difference in the Chinese case is that if an industry with surplus capacity is dominated by SOEs, it is unlikely that these firms will be decisively shut down in China, as the state views large SOEs pillars of its political power and may pressure state banks to lend to these loss-making SOEs. Thus, in 2018 the average industrial capacity utilization (ICU) was a disappointing 76.5% in China but soared to a whopping 102.5% in South Korea and 105.2% in Japan (Table 1).

Associated with China's heavy reliance on investment in economic growth is the fact that China's industrial capacity utilization falls far below major developed economies and even some of the emerging markets such as Brazil. As Table 1 suggests, capacity utilization during 2001-11 in China averaged merely 69.3%, compared to 76.5% in the United States, 83.4% in Germany, and 81.5% in Brazil. While China's capacity utilization improved to 76.5% in 2018, it was still behind the USA (78.5%), Germany (87.1%), and Japan (105.2%).

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<sup>31</sup> Data on China come from NBS, *ibid*. Data on the US are my computation based on data in the following source—"Contribution of Components to Real GDP Growth," posted at <https://research.stlouisfed.org/datatrends/net/page6.php>, accessed April 18, 2019.

<sup>32</sup> World Bank, 1993. *The East Asian Miracle*. New York: Oxford University Press, pp. 220-242.

As Figure 1 indicates, ICU in China started to decline in 2008-9 after it peaked in 2007, thanks to the global financial crisis. ICU rebounded briefly in 2010-11 after China's government rolled out a fiscal stimulus package. But this effect was short-lived, as ICU decreased again in 2012. This might have signaled to China's policymakers the need to arrest its further decline.

As an aforementioned study by Dong, Liang, and Zhang (2015) suggested, heavy industry suffered much greater surplus capacity than light industry. During 2001-11, out of 39 sectors, the ten sectors with the very low capacity utilization ratios belonged to the mining and extraction sectors. Their ratios ranged from 52.5% to 61.8%. In addition, during this period, among the manufacturing sectors, the average ratio of processing of non-ferrous metal ores, whose key production includes electrolytic aluminum and smelting of copper, lead, and zinc, was an abysmal 46.1%. In contrast, the following five light industrial sectors, which tended to be labor-intensive sectors where China's comparative advantage rested, enjoyed the highest capacity utilization rate (above 80%)-- 1) textile, 2) culture and education sporting goods, 3) clothes, apparel, shoes and hats, 4) metal products, and 5) leather and feathers. Among the four regions in China, the western region witnessed the most severe surplus capacity as its industrial capacity utilization averaged merely 46.8%, followed by the northeast (54.8%) and the central region (57.7%). The coastal region had no obvious surplus problem, as its utilization rate averaged 81.3%.<sup>33</sup>

A large surplus capacity resulted in a host of economic problems in China. As noted by the State Council of China in its Guiding Opinions on Resolving the Problem of a Large Surplus

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<sup>33</sup> Dong, Liang, and Zhang, "Industrial Capacity Utilization of China," pp. 89-93.

Capacity promulgated in October 2013, continuous surplus capacity would lead to “mounting financial losses of the sectors, unemployment of employees of the firms, accumulation of bad assets of the banks, degradation of the ecology and the environment, as well as direct endangering of the healthy development of the sectors and even of the improvement of people’s livelihood and social stability as a whole”.<sup>34</sup>

As a result, the State Council (the executive arm of the Chinese state) has introduced a series of policy measures to cope with this problem in the recent decade. For example, in 6 out of the 8-year period of 2006-2013, the State Council promulgated policy documents announcing measures to ease surplus capacity. Table 2 summarizes the sectors or products targeted by these policy documents. It is not surprising that heavy industrial sectors had been the focus of governmental campaigns to reduce surplus capacity. During 2006-13, the sectors which had been mentioned the most frequently in these five policy documents included steel (4 times), cement (3.5 times), plate glass (3 times), coke (3 times), coal (2.5 times), electrolytic aluminum (2.5 times), electric power (2.5 times), calcium carbide (2 times), iron alloy (2 times), and shipbuilding (1.5 times)(Table 2). In particular, four of these products, namely, cement, iron and steel, aluminum, and plate glass, were inputs for construction.

The Chinese decision-makers were keenly aware of the need to address the industrial surplus capacity and find new external markets for China. At the Central Economic Work Conference convened in mid-December 2012 where all the top national and provincial leaders met to discuss tasks for economic affairs of the nation in 2013 (the year when the BRI was announced), economic slowdown and growing surplus capacity were declared the top two domestic challenges for China, whereas a slowdown in the global economic growth and a variety of rising protectionism were identified as the top two stated external economic

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<sup>34</sup> Dong, Liang, and Zhang, “Industrial Capacity Utilization of China,” p. 84.



challenges. In response, the meeting demanded adjustment and remedial plans to cope with surplus capacity as well as a proactive initiative and strategy for opening China's economy.<sup>35</sup>

China's leaders might well have realized that they could use China's industrial surplus capacity, especially surplus capacity in producing needed products in infrastructural construction and transport equipment, in order to fill the infrastructural deficits across Asia. In 2011, a McKinsey report suggested that in the coming decade Asia would need an investment of US\$8 trillion in infrastructure in the order of energy, transport, telecom, and water and sanitation in order to overcome historical underinvestment and meet high growth demand. The report specifically singled out nations such as China and Malaysia as having the greatest capacity to build infrastructure thanks to their adequate "financial depth in their domestic private-capital markets".<sup>36</sup> Nevertheless, China enjoys huge financial assets and manpower for funding massive infrastructure undertaking throughout Asia, whereas Malaysia clearly has far fewer resources. By utilizing China's excess capacity in manufacturing and mining as well as translating its huge holding of foreign reserves into investment abroad, China hopes to help Asia to build up the needed infrastructure in energy, transport, and telecom and help its firms to find new outlets for their products.

It is no coincidence that the products most frequently mentioned by the capacity-reduction policy documents by the State Council during 2006-13 related closely to the energy, transport, and telecom infrastructural projects identified by the aforementioned McKinsey

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<sup>35</sup> "Central Economic Work Conference Held in Beijing," *Renmin ribao (People's Daily)*, December 17, 2012.

<sup>36</sup> Naveen Tahilyani, Toshan Tamhane, and Jessica Tan, "Asia's \$1 trillion infrastructure opportunity," *McKinsey and Company article*, March 2011, posted at <https://www.mckinsey.com/industries/private-equity-and-principal-investors/our-insights/asias-1-trillion-infrastructure-opportunity>, accessed June 1, 2016.

report. The capital- and resource-intensive sectors were not in China's conventional comparative advantage and tended to be dominated by state firms.

In April 2015 Chinese Premier Li Keqiang hosted a forum on the internationalization of China's equipment manufacturing and international production capacity cooperation where he called on China to go beyond benefiting from trade by helping industrialization and job creation in other countries. A month later the State Council issued the Guiding Opinions of the State Council on Promoting International Cooperation in Industrial Capacity and Equipment Manufacturing. In this first high-profile State Council document on international production cooperation, 12 key industries were identified as key sectors for international cooperation of production capacity where China would share its excessive production capacity with developing nations which had suitable conditions and welcomed them.<sup>37</sup>

Eleven of these 12 sectors were heavy industry. They included iron and steel, nonferrous metals, building materials, railway, power, chemicals, automotive, communications, engineering machinery, shipbuilding and marine engineering, and aerospace. The first ten sectors had the obvious excessive capacity and overlapped products in Table 2. Some of these sectors were closely associated with the mining and manufacturing sectors with the lowest rate of capacity utilization mentioned earlier, such as ferrous and nonferrous metals

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<sup>37</sup> "Premier's 'business card' is global capacity cooperation," posted at [http://english.gov.cn/policies/policy\\_watch/2015/07/27/content\\_281475155523468.htm](http://english.gov.cn/policies/policy_watch/2015/07/27/content_281475155523468.htm) on Jul 27, 2015, accessed October 20, 2017. The policy document in May 2015 was also mentioned in Yu Miaojie and Jin Yang, "Channeng guosheng de xianzhuang, qianyin houguo yu yingdui" ("The Status, Causes, Consequences and Remedies of Surplus Capacity"), *Working Paper Series of Centre for Economic Research of Beijing University*, No.C2017015, December 28, 2017.

and equipment production. This document specifically suggests that international capacity cooperation would help with the implementation of the BRI.<sup>38</sup>

While the official rhetoric in these documents emphasized free trade and the benefits for the recipient countries, a clear motivation was to find external outlets and markets for excessive manufacturing and mining capacity. In this sense, the BRI would help China to sustain its investment-driven growth model while minimizing the hugely unpleasant side-effects, such as bankruptcies and massive lay-offs of the sectors with large surplus capacity.

Empirical evidence also suggested that the countries in the BRI became major export markets of China's steel products in an initial year of the BRI. For example, seven Asian countries included by the Chinese government in the BRI, namely, South Korea, Vietnam, the Philippines, Thailand, Indonesia, Singapore, and India, were among the ten top export markets of China's steel products in terms of trade value in the first eleven months of 2014, accounted for 36.4% of China's exports, even though South Korea and India have yet to officially participate in the BRI.<sup>39</sup>

Available data on the performance of the industry shed light on the effects of the BRI in easing surplus capacity. On the bright side, in the wake of the launch of BRI in the second half of 2013, both the liabilities to assets ratio and the inventories to assets ratio in China's

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<sup>38</sup> “Guowuyuan guanyu tuijin guoji channeng he zhuangbei zhizao hezuo de zhidao yijian” (the Guiding Opinions of the State Council on Promoting International Cooperation in Industrial Capacity and Equipment Manufacturing), posted at [http://www.gov.cn/zhengce/content/2015-05/16/content\\_9771.htm](http://www.gov.cn/zhengce/content/2015-05/16/content_9771.htm), accessed January 13, 2019.

<sup>39</sup> Yu Yanling, Zhu Yibo, and Li Hanbin, 2017, “A Study on the Remedy of Surplus Capacity of China's Steel Industry and Its Structural Upgrade,” *Xiandai Shangmao Gongye (Modern Commercial and Trade Industry)*, No. 6, pp. 8-10.

industry declined in a row during 2013-16, thus reducing the financial risks of the industry as a whole. However, in 2017, both ratios edged up very slightly from 2016 (Table 3). The ups and downs of ICU seem less straightforward. As Figure 1 and Table 3 suggest, ICU continued to decline slowly during 2013-16, though its decline was not as steep as during 2011-12. In 2017 ICU staged a spectacular recovery and stayed on a decent level despite a minor drop during 2018-9.

Exports of steel and cement from China to Pakistan and Malaysia, arguably the nation hosting two of the largest projects in Asia, give us a glimpse of the possible effects on these industries in China and the BRI participants. Partly thanks to the demands for steel and cement from the China-Pakistan Economic Corridor (CPEC), a landmark BRI project, Pakistan saw imports of iron and steel from China soaring from US\$0.474 billion to US\$1.18 billion during 2013-17. Under competition from imports local production with outdated technology contracted by 8.6% in the first half of the fiscal year (FY) of 2016 after growing by 31% during the same period of the previous FY.<sup>40</sup> Limited data on Malaysia seems to paint a similar picture. During the 2009-2018, Malaysia's imports of iron and steel surged by 107%. In 2018, China was the largest importing source of Malaysia's imports of iron and steel, accounting for 26% of its imports, and China's exports grew by 14%. Imports of iron and steel from China were followed by other Asian producers. Even though Malaysia had 100 steel producing and processing facilities, its exports declined by 43% during 2009-18. In order to protect their domestic industries, Pakistan filed five anti-dumping (AD) measures in

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<sup>40</sup> Shahid Iqbal, "Steel imports to hit \$2.2bn as local production rusts away," posted at <https://www.dawn.com/news/1252399> on April 16, 2016, accessed January 6, 2020.

2019 and Malaysia four AD measures against China in 2018. In Malaysia, China was the largest AD target.<sup>41</sup>

The picture of cement trade is more benign and even encouraging. The huge demand from the CPEC and the limited capacity in Pakistan stimulated a rapid expansion in production capacity. The capacity grew from 45.6 million tons during 2014-5 to 59.7 million tons during 2019-20, and domestic sales also soared from 28.2 million tons to 40.3 million tons (despite a near 2% drop in the last FY). Cement became one of the largest cash cows for the federal government in the FY of 2016. Reliable data on Malaysia's cement imports from China seem lacking. Nevertheless, a recent report suggested that due to tightened environmental restrictions on cement production in China China's cement exports free fell and its imports, especially from Southeast Asia, soared in 2018.<sup>42</sup>

We can also examine the economic performance of the industrial sectors most affected by surplus capacity before and after the launch of the BRI in 2013, especially those mentioned most frequently in the State Council policy documents in Table 2. Figures 2 and 3 illustrate the capacity utilization of three and five, respectively, of the sectors suffering from surplus capacity and mentioned most frequently in Table 2. Both figures are based on the data on ICU from Chen, Li and Zhu 2019. With a partial exception of manufacture of non-metallic mineral products (which would include cement, plate glass, polycrystalline silicon, and building materials) whose capacity improved in 2013 and 2014, capacity utilization of the

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<sup>41</sup> Global Steel Monitor, 2019a. *Steel Imports Report: Malaysia*, June 2019; Global Steel Monitor, 2019b. *Steel Imports Report: China*, September 2019.

<sup>42</sup> Data on "Historical Analysis" on APCMA (All Pakistan Cement Manufacturing Association); information from multiple internet websites such as <http://www.cbmf.org/cbmf/xydt/xyxx/68858753/index.html> and <https://oec.world/en/>. [http://www.fdi.gov.cn/1800000628\\_18\\_7439\\_0\\_7.html](http://www.fdi.gov.cn/1800000628_18_7439_0_7.html) and <https://m.sohu.com/n/471356466/>, accessed January 6, 2020.

other two sectors in Figure 2 and the five sectors in Figure 3 continued to fall to various extents during 2013-16. The only credit we may give to the BRI is that the fall in smelting and pressing of non-ferrous metals and ferrous metals (Figure 2), manufacture of non-metallic mineral products (Figure 2), mining and processing of non-metal ores, ferrous metal ores, and non-ferrous metal ores, and production and supply of electric power and heat power (Figure 3) seems to be moderated in 2013, possibly thanks to the launch of the BRI.

Overall, the BRI seems to have a detectable effect on easing the liabilities to assets ratio and the inventories to assets ratio of the industry during 2013-16 and improved the capacity utilization of the industry during 2017-9. Judged by the post-BRI capacity utilization of the sectors identified by the state as top priorities for remedial, however, the positive effects of the BRI seem temporal and limited. The BRI only arrested the decline of the capacity utilization of most of the eight sectors of this kind in 2013, and fails to reverse the decline of all these sectors during 2014-16 (Figures 2 and 3). After the BRI China's exports of steel and iron threatened to drive their counterparts in Pakistan and Malaysia out of business, cement producers in Pakistan enjoyed booming business at home and those in Southeast Asia booming exports to China.

### *Secure Routes for Energy Imports*

The BRI would also help China to increase the safety of its strategic sea lanes from the India Ocean, the Straits of Malacca, and the South China Sea. China might even improve the safety of its sea lanes further into the Red Sea and the Mediterranean Sea if China could forge good ties with littoral states along these waters. The BRI, especially the progression of the

land-based New Silk Road, would enable China to ensure the safety of its energy imports over this land bridge.

This imperative to secure energy importing routes has much to do with the fact that China's economic growth has become energy-intensive. Fuelled by a rapidly growing number of trucks, passenger cars, and commercial airplanes, as well as the need to build up petroleum reserves, China was responsible for the world's largest growth in demand for petroleum and other liquid fuel nine years in a row since 2009.

As a result of China's rapid demand for energy, China's dependence on imports of crude oil and oil reached a new high level into the 2010s. In 2012 China had a net import of 327.1 million tons of oil, accounting for 57% of the oil consumption. The main oil supplying regions were the Middle East, which constituted 44% of China's oil imports, followed by Africa (19.7%), the former Soviet Union especially Russia and Central Asia (18.3%), Latin and North America (10.4%), and Asia Pacific (7.7%).<sup>43</sup> On the other hand, China started to import natural gas in 2006. By 2012, China imported 42.8 billion cubic meters of gas, accounting for 29% of its gas consumption.<sup>44</sup> The top supplying nations were Turkmenistan (51.4% of China's imports via gas pipelines), Qatar (16.4% via LNG, same for the named

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<sup>43</sup> "2006-2012nian Zhongguo shiyou jinchukouliang ji lai yuan" (Amounts and Sources of China's Petroleum Imports and Exports), posted at [http://www.cnenergy.org/yq/201307/t20130715\\_44265.html](http://www.cnenergy.org/yq/201307/t20130715_44265.html) on July 13, 2013, accessed September 1, 2018.

<sup>44</sup> "Zhongguo shiyou: 2012nian woguo youqi duiwai yicundu jixu shangsheng" (China's Petroleum: In 2012 China's Dependence on External Oil and Gas Continued to Rise), posted at [http://www.gov.cn/jrzq/2013-01/30/content\\_2323461.htm](http://www.gov.cn/jrzq/2013-01/30/content_2323461.htm) on January 30, 2013; accessed September 17, 2018.

nations that follow), Australia (11.7%), Indonesia (8.0%), Malaysia (6.1%), Yemen (2.0%), Russia (1.2%), Nigeria (1%), and Egypt (1%).<sup>45</sup>

China's oil imports from the Middle East and Africa had to be transported through sea lines of communication (SLOC) across the Indian Ocean (IO), through the Straits of Malacca (SM) and the South China Sea (SCS)(the IO-SM-SCS SLOC), and these imports amounted to 63.7% of China's oil imports in 2012. China's gas imports are far less reliant on the aforementioned SLOC. Only about 34.9% of gas imports, that is, those from the Middle East, Africa and Southeast Asia, or at best 45.6% if China's imports from Australia are also included, may need to be shipped along the whole or part of the IO-SM-SCS SLOC.

The fact that the majority of the crude oil and oil needs to be imported in order to satisfy China's domestic consumption and that the overwhelming majority of the crude imports have to be shipped through the IO-SM-SCS SLOC heightened the concerns of China's strategic planners. China still does not have the capability of projecting its naval power far away from its coast. China's naval power is dwarfed by the US. The United States has 10 operational aircraft carriers, plus 9 potential ones, whereas China has only an operational one plus three being built or tested. Any disruption of this strategic sea lane by external forces (say, the US or Indian navy) could jeopardize the stability of energy imports for China.<sup>46</sup>

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<sup>45</sup> "2012nian Zhongguo tianranqi jinkou laianguo ji jinkouliang" (Sources of China's Natural Gas Imports and Amount in 2012), posted at <https://www.china5e.com/news/news-342770-1.html> on June 26, 2013, accessed January 13, 2016.

<sup>46</sup> For an earlier and systemic survey of China's energy security, diplomacy and consideration of alternative importing routes away from the Strait of Malacca, refer to Hongyi Harry Lai, 2007. "China's Oil Diplomacy: Is It a Global Security Threat?," *Third World Quarterly*, 28: 3: 519-537.



As early as 2004, China started to pay serious attention to its heavy reliance on the IO-SM-SCS SLOC and has been developing alternative routes. By 2012, as reported by the Chinese and English news sources the following four routes of energy imports had been established or were under construction as alternatives to the IO-SM-SCS SLOC.<sup>47</sup>

1) The Central Asia-China oil and gas pipelines, which I coin Land Route 1 of China's energy imports. This route includes one oil pipeline and a gas pipeline. The Kazakhstan-China oil pipeline, designed to transport 20 million tons of oil from the largest oil supplying nation in Central Asia (i.e., Kazakhstan) to western China, was put into use in 2004. In addition, multiple lines of gas pipelines of 1,833 km connect the largest gas supplier in Central Asia (i.e., Turkmenistan) with western China, and a further 8,000 km of pipelines would transport natural gas all the way to Shanghai and Guangzhou. The gas pipeline was put in service in 2009.

2) The Eastern Siberia-China oil and gas pipelines (Land route 2). The Eastern Siberia-China crude oil pipeline connects Taishet in Siberia with Daqing in northeastern China, stretching 4,770 km and boasting a capacity of 15 million tons a year. The Eastern Siberia-China natural gas pipeline (Yakutia-Khabarovsk-Vladivostok-Heihe-Shanghai pipeline) comprises of 3,000 km of pipeline in Russia and 3,371 km in China. With a designed annual capacity of 38 billion cubic meters, it was expected to meet 16% of China's gas need in 2017. Its operation has been scheduled in 2019.

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<sup>47</sup> The information below is based on numerous Chinese and multiple English news sources, especially entries and reports on these items on google news search. For a representative overview, see "Zhongguo sida nengyuan tongdao" (China's Four Major Energy Transport Routes), *Changjiang Ribao (Yangtze Daily)*, June 5, 2013, posted at <https://www.china5e.com/news/news-340830-1.html>; accessed January 13, 2018.

3) The Myanmar-China oil and gas pipelines (Land route 3). This route also comprises an oil pipeline and a gas pipeline, both at a length 771 km inside Myanmar, connecting Kyaukpyu of Myanmar, a deepwater port on the Indian Ocean, with Ruili of Yunnan Province. With a designed capacity of 22 million tons a year the oil pipeline would run another 1,623 km inside China until it reaches Chongqing. The gas pipeline would run for another 1,727 km inside China and would end in Guigang in Guangxi. It is designed to transport 12 billion cubic meters a year. As of 2012 construction of both pipelines was smoothly progressing. The gas pipeline was in operation in July 2013 and the oil pipeline in January 2015.

4) The China-Pakistan economic corridor (CPEC). Rails, oil, and gas pipelines have been proposed to link up southern Xinjiang with Pakistan's deepwater Gwadar port on the Indian Ocean (Land route 4). Specifically, rails and highways will be built to link up southern Xinjiang, especially its major city Kashgar with cities across Pakistan as well as Gwadar. Numerous infrastructural projects are underway.

The BRI would not only enable China to expand and consolidate the existing land routes of energy imports and to complete the proposed land route (Land route 4, or the CPEC), but also would allow it to secure the existing primary route of energy imports through the critical IC-SM-SCS SLOC. It would thus allow Beijing to ease concerns with its energy imports and have more options to deal with possible disruptions of oil and gas imports.

First of all, the BRI would further China's infrastructural links through the existing rails, highways, oil and gas pipelines with countries along the three largely completed land routes of energy imports, such as Kazakhstan and Turkmenistan in Central Asia, Russia's Siberia, and Myanmar. For example, China and these nations have proposed and inaugurated

additional lines in Land Routes 1-3. For example, Line C of the Central Asia-China gas pipeline was under construction in September 2012 and the construction Line D was started in September 2014 and was scheduled to be completed in 2020.<sup>48</sup> Second, the BRI also enables China to expand the existing energy and infrastructural linkages with nations along Land Routes 1-3 of energy imports. China has also proposed new energy cooperation projects especially electric power projects with these nations, especially those in Central Asia and Myanmar. In September 2012, the construction of the Eastern Siberia-China natural gas pipeline with an annual capacity of 38 billion cubic meters of gas to China was inaugurated, and its completion was expected in 2019. Third, through the BRI platform, China and Pakistan can make the progress and eventually complete the CPEC and Land Route 4 for China's energy imports, adding a new alternative route in case of a major disruption of the maritime route. Fourth, China could forge closer economic linkages with key littoral states along its maritime route of energy imports, such as Indonesia, Malaysia, Singapore, and Sri Lanka. China has been pushing forth or has started large-scale infrastructural projects in Malaysia, Indonesia, and Sri Lanka. These projects included the East Coast railway in Malaysia, the Jakarta-Bandung high-speed rail in Indonesia, and an industrial zone in Hambantota, as well as the construction of the Colombo International Container Terminal and the Mattala Rajapaksa International Airport (MRIA) in Sri Lanka. When launching the BRI in 2013 China's decision-makers might have hoped that these infrastructural projects would enhance the economic significance of China for these nations and that these countries would be more willing to help China to ensure the safety of its SLOC.<sup>49</sup>

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<sup>48</sup> Information on the Central-Asia gas pipeline and Line D of the pipeline posted on <https://baike.baidu.com/item>, accessed January 13, 2019.

<sup>49</sup> Reports and progress on these projects are too abundant to cite. See, for example, "China's Belt and Road Initiative (BRI): A sustainable partnership for Sri Lanka?," posted on <http://www.ft.lk/opinion/China-s-Belt-and-Road-Initiative--BRI---A-sustainable-partnership-for-Sri-Lanka-/14-666794> on November 14, 2017, accessed 14 January 2018. In hindsight, China's leaders might have underestimated the difficulties of these

While systemic data and assessment on the progress and achievement of the aforementioned energy importing routes in the recent few years do not seem to be available, news reports and data from multiple sources permit us to form a preliminary view on the effects of the BRI on China's oil imports. As Figure 4 illustrates, China's crude oil imports grew robustly during 2012-17, rising from 270 million tons to 462 million tons. In 2017, China surpassed the United States to be the world's largest net importer of crude oil.<sup>50</sup> Among the largest suppliers of crude for China, Saudi Arabia, which does not have a land-based energy supply route to China and whose exports to China rely heavily on the IO-SM-SCS SLOC, experienced a steady decline in its share in China's crude imports during 2012-18, from nearly 20% to slightly over 12%. Meanwhile, Russia, which has benefited from the aforementioned Eastern Siberia-China oil and gas pipelines, saw its share of China's crude imports soaring from 9% to over 15% during 2012-18. In particular, Russia exported roughly 25 million and 30 million tons of crude to China in 2017 and 2018, respectively, accounting for a whopping 42% of its crude exports to China in these two years. The phenomenal growth of exports by land routes allows Russia to eclipse Saudi Arabia to be the largest crude supplier to China during the three years period of 2016-18.<sup>51</sup> China has thus witnessed world-leading crude imports while turning Russia into its single biggest supplying source. Forty

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projects and the external backlashes toward them. However, this did not change the fact that China's leaders were hoping to forge closer ties with host nations through cooperation in launching these projects.

<sup>50</sup> "China Overtook the US as World's Largest Crude Oil Importer in 2017," posted at <https://worldmaritimeneews.com/archives/267845/china-overtook-the-us-as-worlds-largest-crude-oil-importer-in-2017/>, accessed January 10, 2018.

<sup>51</sup> Reports and progress on these projects are too abundant to cite. See, for example, "Shaking Off Saudi Arabia, Russia Is Locked in the Status of China's Largest Crude Supplying Nation," posted on [http://www.guancha.cn/economy/2017\\_10\\_25\\_432254.shtml](http://www.guancha.cn/economy/2017_10_25_432254.shtml), accessed 14 January 2019.

percent of Russia's crude was exported to China through land-based routes, far more secure than the SLOC.

Other than the complementary energy relations, China-Russia energy partnership is induced by their mutual geopolitical needs. They feel the pressure from the US-dominated unipolar world and are often stung by the West's criticisms toward their authoritarian regimes and their perceived aggressive external moves (such as China's assertive moves in the South China Sea and Russia's annexation of Crimea). As a matter of fact, their energy partnership was forged back in the 1990s. As long as these structural and political constraints imposed by the West remain unchanged, and as long as China and Russia do not clash over immediate issues of vital importance, China-Russia energy partnership seems likely to persist.

#### *Make the Western Region a New Growth Area*

Through the BRI China's decision-makers also intend to expand the trade links and speed up the growth momentum of China's western region, thereby reducing regional inequality in China. For decades China's economic growth has been primarily driven by the coastal region. Thanks to its proximity to the sea and sea lanes, better infrastructure and technology, higher human capital, and earlier history of opening to the world economy in the reform era, the coast has been the primary engine of China's phenomenal economic growth and the home of dynamic non-state (private) firms. For example, during 1978-98 the coastal region raised its share obviously in China's GDP from 43.7% to 51.1%, whereas the share of the western region declined from 20.6% to 17.7%. Bear in mind that the coastal region had a higher per capita GDP in the early years of this period. As a result, the ratio of per capita GDP of the western region declined from an already alarming 40% of that of the coastal region in 1982,

to even more abysmal 33.8% in 1998 (Table 3). Such severe regional inequality had caused discontent from the western region (the west in short).

In response, in 1999 Chinese President Jiang Zemin and Premier Zhu Rongji commenced the western development program, aiming to improve the infrastructure (including energy, road, railway, airports, ports, and telecommunications) and develop the sectors with a comparative advantage in the western region (such as resources and energy). One of the immediate aims of the program was to address a rising gap in development across regions and to fulfill Deng's pledge to the inland region that by the turn of the 20<sup>th</sup> century shared prosperity among regions should be promoted.<sup>52</sup>

After nearly 14 years of endeavor, the western developmental program had registered several noticeable successes. First and perhaps most importantly, the economy in western provinces had been growing noticeably faster than that in the coastal provinces. The average GDP growth in the western provinces accelerated from 8.8% in 1998, a year prior to the official inauguration of the western developmental program, to 11.6% in 2012, a year prior to the commencement of the BRI. Meanwhile, the average growth in the coastal provinces decelerated sharply from 10.2% to 8.1%. As a result, the average growth rate in the western provinces soared from 1.3% behind that of the coast to 3.5% ahead of it. The west had clearly reversed its relatively disadvantage in the pace of economic growth against the coast. Second and as a result, the ratio of the per capita GDP of western provinces to that of the coast had improved impressively from 33.8% to 51.9%, cutting the gap from 66.2% (of the

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<sup>52</sup> For a discussion of the discontents from the elites in the western region toward regional inequality and the rationale of the western developmental program, see Hongyi Harry Lai, "China's Western Development Program: Its Rationale, Implementation, and Prospects," *Modern China*, Vol. 28, No. 4, October 2002: 432-40.

average of the coast) to 48.1%. Third, thanks to the economic catch-up, the share of the western provinces in the national GDP had increased from 17.7% to 19.8% during 1998-2012 (Table 4). The impressive turnaround in the economic conditions of the western region in the wake of the western developmental program suggests to China's decision-makers that a continuous push to develop the western region should be fruitful. Finally, as far as external linkage of the regions is concerned, the west's share in the nation's foreign trade grew from 4.2% to 5.6% during 1998-2012, but its share in foreign investment in capital construction fell from 8.9% to 5.8% (Table 5), indicating a need to increase foreign capital inflows into the west.

The BRI comprises of two economic belts, namely the land-based economic belt of nations along the Silk Road, and the maritime economic belt of nations starting from southeast coastal China, through Southeast Asia along the South China Sea and South Asia across the Indian Ocean, to the Middle East and Europe. The land-based new Silk Road would commence from Xi'an, the capital city of Sha'anxi Province, linking up through China's provinces such as Gansu, Qinghai, and Xinjiang, into Central Asia, the Middle East and then Europe. This external link would help expand export markets and generate outward investment outlets for western China. China's decision-makers have coined the BRI as a new round of opening of China's economy, hoping that it could bring similar economic benefits for the western region as China's opening in the previous decades had done to the dynamic coastal region.

The economic performance of the western region compared to other regions allows us to assess the possible impact of the BRI. The BRI apparently has succeeded noticeably in extending the external trade and investment linkages of the west. As illustrated in Table 5,

the west increased its share in China's foreign trade from 5.6% in 2012, to 6.8% in 2017, a clear improvement. More importantly and significantly, the west had more than doubled its share in the nation's foreign funds in investment in capital construction, raising the share from 5.8% in 2012 to 11.8% in 2017. Meanwhile, the shares of the coastal region in the nation's trade and foreign investment in capital construction declined from 85.6% to 83.3% and from 70.2% to 56.7%, respectively. It thus seems that the infrastructural and economic linkages between the western provinces and the nations along the BRI have intensified since 2013, thereby propelling the growth of the economy of the west, while the coast's weight in China's external linkage declined noticeably despite its continuing dominance.

In 2017, the annual growth rate of the twelve western provinces averaged 7.7%. Even though it was sharply lower than that in 2012 (11.6%), it was noticeably higher than that of the ten coastal provinces (6.9%). Despite higher growth than the coast in 2017, the average per capita GDP of the twelve western provinces was 50.4% of the average of the six coastal provinces in 2017, lower than 51.9% in 2012. A possible reason is that the west increased its share in the nation's population from 27% to 27.2% during 2012-17 (Table 4), likely suggesting that more people decided to live and work in the west instead of moving to the other regions as the local economy was doing relatively well. Nevertheless, the share of the twelve western provinces in the nation's GDP improved from very slightly from 19.8% in 2012 to 19.9% in 2017. Overall, it appears that the BRI has enabled the western region to grow faster than the coast and maintain its share in the national economy, though the ratio of its per capita GDP ratio to the coast had declined modestly. As the share of the coastal region in China's GDP also rose from 51.3% to 52.9% during 2012-17, it appears that the coast has also benefited to some extent economically from the BRI, likely through active participation in the maritime silk road initiatives.



Xinjiang, a western province, has yet to take full advantage of the BRI. In the recent few years, the negative international limelight on the treatment of Uighurs in the so-called re-education centers has aroused strong criticisms from Western nations, international media, and human rights organizations. Extraordinary tight security in Xinjiang might also discourage tourists, business people, and potential investors, though China's authority maintains that it and these centers contribute to the absence of violent attacks in the province since 2013. The Chinese statistics suggested that during 2013-2018 Xinjiang economic growth decelerated faster than the nation and the western region, and as a result, its annual growth rate deteriorated from 2.2% above the national average to 0.6% below it.<sup>53</sup> In the first eleven months of 2019 growth in the province seemed to have taken a nosedive, as the value-added of the large-scale industry grew by merely 5.0% and fixed-assets investment a sluggish 3.5%. Even the extremely dynamic foreign trade yields a worrisome sign, as the growth rate of imports outpaced that of exports by a ratio of exceeding 2.5: 1 (62% vs. 24%).<sup>54</sup>

## Conclusion

This article, through highlighting the domestic-external linkage, sees the BRI not simply an ad hoc response to China's slowdown in economic growth and to the US intensified strategic pressure. Rather, it conceives the BRI as a strategy to help ensure the economic growth and ease economic vulnerabilities, thereby ensuring the survival of the economic and political regimes in China. Economically, China's growth has expediently relied on investment as

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<sup>53</sup> The analysis is based on data released by multiple publications and yearbooks published by the China Statistical Bureau from multiple years.

<sup>54</sup> "A profile of the operation of the economy in Xinjiang in the first eleven months of 2019," Posted [https://www.ndrc.gov.cn/fggz/fgzh/gnijjc/dqjj/201912/t20191231\\_1218296.html](https://www.ndrc.gov.cn/fggz/fgzh/gnijjc/dqjj/201912/t20191231_1218296.html), accessed January 12, 2020.

external demand remains sluggish in the recent decade. A heavy reliance on investment and impulsive use of investment by local government, coupled with the continuous state protection of large state firms with a large presence in heavy industry and mining, has resulted in a surplus in production capacity in a number of sectors. In addition, a growing demand for energy, driven by China's manufacturing and growing transport, results in a rising reliance on imported oil and gas and necessitates the construction of land-based routes for energy imports. Furthermore, China's economic growth has been driven by the coast, whose economic slowdown due to external shocks could have derailed the nation's growth.

In launching the BRI China's leaders hoped to ameliorate these three vulnerabilities. The BRI would allow China to devote its surplus capacity to building infrastructural and industrial projects in Eurasia, and to even transfer some of the surplus capacity to other nations in the BRI, thereby sustaining China's economic growth while reducing the grave risks of massive bankruptcies and unemployment and appeasing SOEs in these sectors. Furthermore, the BRI, especially intensified linkage of China's western provinces with Eurasia, would permit these provinces to claim a greater share of national economic growth and would allow China's leaders to achieve regional equality, satisfy the demand from the elites and population from western provinces, and alleviate the risks of over-reliance on the coast. Finally, construction of land-based energy importing routes through western China would allow China to expand energy imports on the one hand, and ensure their safety on the other, as the land-route imports are less vulnerable to external sabotage and blockades. All these measures would help the survival of China's economic regime and the ruling party.

Evidence and data also allow us to reach a tentative assessment of the accomplishment of the aforementioned three objectives of the political economy. First of all, the BRI seems to have

at best moderated the aggravation of surplus capacity in the industry in 2014 and has managed to increase industrial capacity utilization during 2017-19. Nevertheless, the positive effects of the BRI seem mild for the sectors identified by the State Council as requiring the most urgent remedies for surplus capacity. The BRI only halted the decline of the capacity utilization of most of the eight sectors of this kind during 2013-14, but not during 2014-16. Externally, China's sectors with a large surplus and robust export capacities such as iron and steel have found new external markets, but run a risk of aggravating trade disputes and driving out local industries. On the other hand, China's declining sectors such as cement create opportunities for imports from other nations. Secondly, the BRI seems to forge a much closer energy partnership between China and Russia and has enabled Russia to overtake Saudi Arabia as China's largest crude oil supplier during 2016-18. The BRI allows a greater amount of crude to be exported from Russia to China through pipelines while China's crude imports soar to a world-topping high level. Finally, the BRI has allowed the western region to expand rapidly its foreign trade and foreign investment inflows, increase its share in the nation's totals, thereby growing faster than the coast and maintaining its share of the nation's GDP.

In short, this study examines the role of a major external strategy like the BRI in mitigating economic vulnerabilities and in serving the economic regime and political interests of the ruling party. This analytical approach could help us to enrich our understanding of this major strategy in the international political economy well beyond the usual focus on international causes of such a strategy.

## Tables and Figures

Table 1. Average Industry Capacity Utilization in Major Economies (%)

	2001-11	2018	The Month of Data in 2018
China	69.30	76.5	September
United States	76.50	78.5	November
Germany	83.4	87.1	December
UK	78.9	80.2	December
Brazil	81.5	77.1	October
South Africa		81.2	September
Japan		105.2	October
South Korea		102.5	November

Sources: Dong, Liang and Zhang, 2015: 89; “Trends in capacity utilization around the world,” posted <https://fredblog.stlouisfed.org/2018/04/trends-in-capacity-utilization-around-the-world/> on April 9, 2018, accessed January 11, 2018; “Capacity Utilization of the World,” posted at <https://tradingeconomics.com/country-list/capacity-utilization>, accessed January 11, 2018.

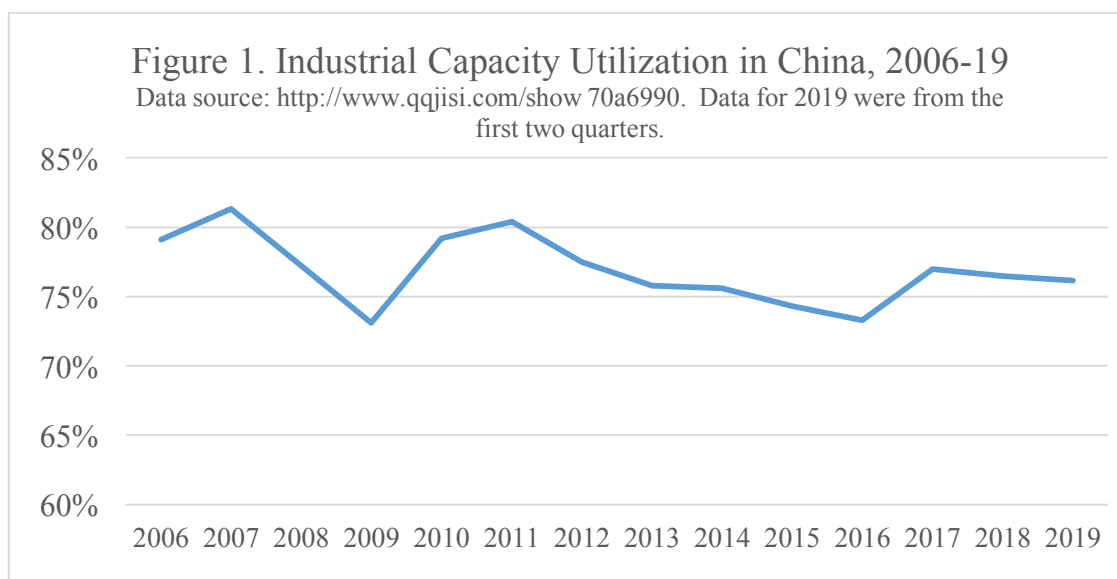


Table 2. Industrial Sectors with Considerable Surplus Capacity Named in the Policy Documents of the State Council, 2006-13

Document Number and Year of Promulgation	Sectors with Considerable Surplus Capacity
No. 11, 2006	Steel, electrolytic aluminum, calcium carbide, iron alloy, coke, automobile. Sectors with possible surplus capacity: cement, coal, electric power, and textile
No. 15, 2007	Electric power, steel, building materials, electrolytic aluminum, iron alloy, calcium carbide, coke, coal, plate glass
No. 38, 2009	Steel, cement, plate glass, coal chemical industry, polycrystalline silicon, wind power equipment. Sectors with possible surplus capacity: electrolytic aluminum, shipbuilding, soy squeezing
No. 7, 2010	Electric power, coal, steel, cement, non-ferrous metal, coke, papermaking, tanning, printing, and dyeing
No. 41, 2013	Steel, cement, electrolytic aluminum, plate glass, ship
Number of mentions in the documents (mention of surplus capacity)	Steel (4), cement (3.5), plate glass (3), coke (3), coal (2.5), electrolytic aluminum (2.5), electric power (2.5), calcium carbide (2), iron alloy (2), shipbuilding (1.5), coal chemical industry (1),

count as 1; mention of possible surplus capacity counts as 0.5)	papermaking (1), polycrystalline silicon (1), wind power equipment (1), non-ferrous metal (1), tanning (1), printing, dyeing (1), building materials (1), textile (0.5), and soy squeezing (0.5)
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Source of the list of sectors in the five documents: Yu Miaojie and Jin Yang, “Channeng guosheng de xianzhuang, qianyin houguo yu yingdui” (“The Status, Causes, Consequences and Remedies of Surplus Capacity”), *Working Paper Series of Centre for Economic Research of Beijing University*, No.C2017015, 28 December 2017. The tally is mine.

Table 3. Capacity Utilization and Liabilities and Inventories to Assets Ratios in Industry

	Capacity Utilization Rate	Liabilities to Assets Ratio	Inventories to Assets Ratio
2006	79.1%	57.5%	12.7%
2007	81.3%	57.5%	12.8%
2008	77.2%	57.7%	12.5%
2009	73.1%	57.9%	11.5%
2010	79.2%	57.4%	11.8%
2011	80.4%	58.1%	11.9%
2012	77.5%	58.0%	11.5%
2013	75.8%	58.1%	11.2%
2014	75.6%	57.2%	10.8%
2015	74.3%	56.6%	10.0%
2016	73.3%	55.9%	9.9%
2017	77.0%	56.0%	10.1%
2018	76.5%		
2019	76.2%		

Sources: <http://www.qqjjsj.com/show70a6990>; China Statistical Yearbook 2018.

Figure 2. Capacity Utilization of Selected Industrial Sectors in China, 2006-16 (Part 1)(Source: Chen, Li, Zhu 2019)

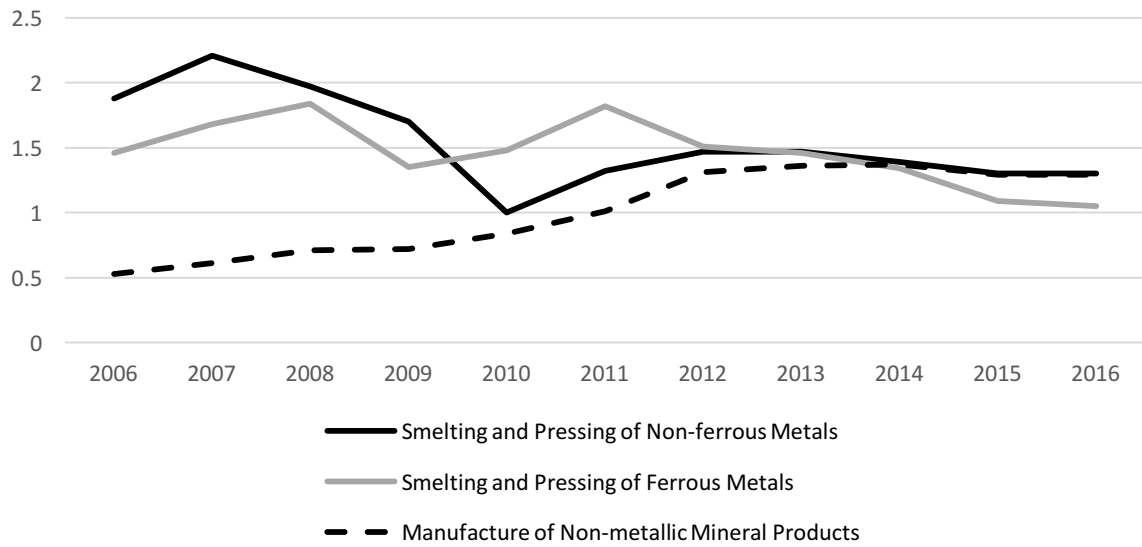
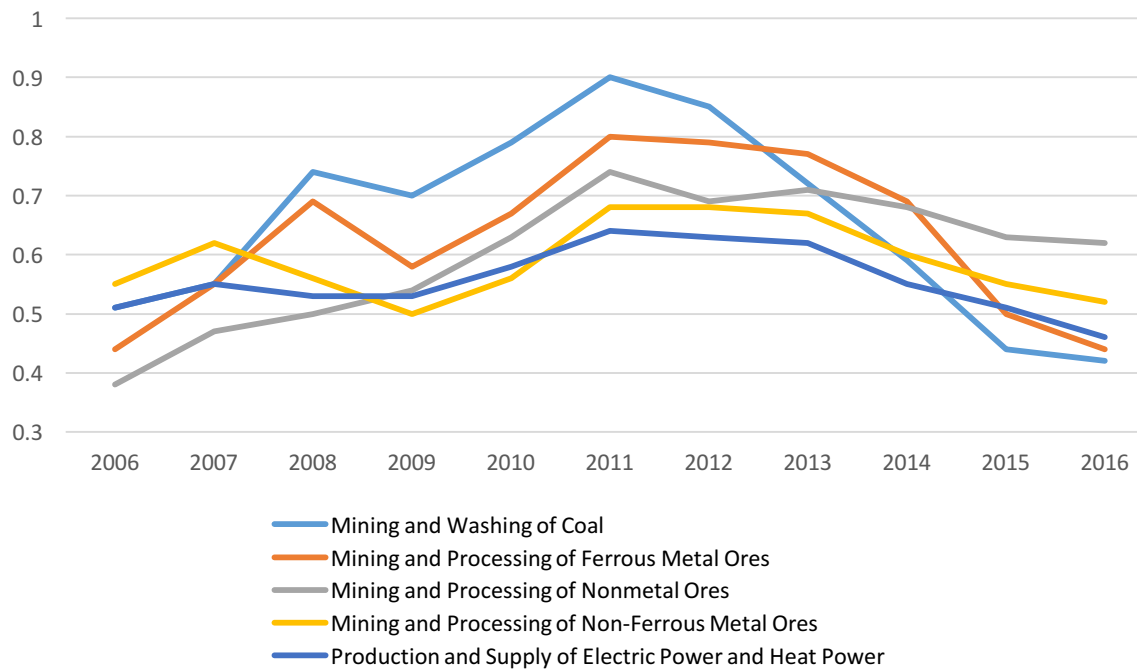


Figure 3. Capacity Utilization of Selected Industrial Sectors in China, 2006-16 (Part 2)(Source: Chen, Li, and Zhu 2019)



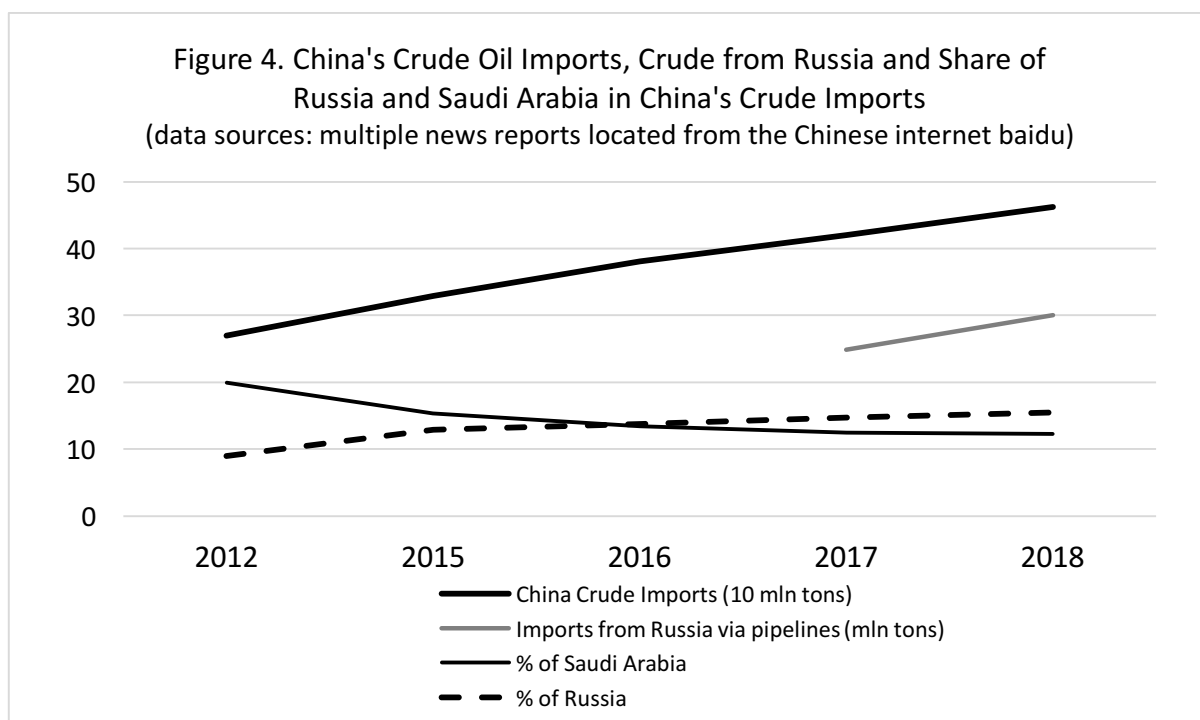


Table 4. Economic Development of Four Major Regions in China (provincial average)

	GDP Growth			Per Capita GDP Relative to the Coast (=100%)			The Share of Nation's GDP		
	1998	2012	2017	1998	2012	2017	1998	2012	2017
Four Regions									
Coastal (10)	10.2%	8.1%	6.9%	100.0%	100.0%	100.0%	51.1%	51.3%	52.9%
Central (6)	9.0%	10.6%	8.0%	40.1%	51.9%	52.6%	21.2%	20.2%	20.8%
Western (12)	8.8%	11.6%	7.7%	33.8%	51.9%	50.4%	17.7%	19.8%	19.9%
Northeast (3)	8.5%	10.5%	5.3%	60.8%	72.4%	55.4%	10.0%	8.8%	6.4%
Coast-west gap	1.3%	-3.5%	-0.8%	66.2%	48.1%	49.6%	33.4%	31.6%	33.0%

Notes: Numbers of provinces in parentheses next to each region. The author's own computation using data from *China Statistical Yearbook*, various years during 1999-2018.



Table 5. Trade and Foreign Investment of Four Major Regions in China (provincial average)

	Share of China's Foreign Trade Volume (by origin)			The Share of Nation's Foreign Funds in Investment in Capital Construction		
	1998	2012	2017	1998	2012	2017
Four Regions						
Coastal (10)	85.2%	85.6%	83.3%	73.3%	70.2%	56.7%
Central (6)	4.7%	5.5%	7.3%	11.5%	14.0%	20.2%
Western (12)	4.2%	5.6%	6.8%	8.9%	5.8%	11.8%
Northeast (3)	5.8%	3.3%	2.6%	6.2%	10.0%	11.3%
Coast-west gap	81.0%	80.0%	76.5%	64.4%	64.4%	44.9%

Notes: Numbers of provinces in parentheses next to each region. The author's own computation using data from *China Statistical Yearbook*, various years during 1999-2018.